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SUBJECT: KAZAKHSTAN: PRODI VISIT FOCUSES ON ENERGY

11. (SBU) Summary: During his October 8-9 visit to Kazakhstan, Italian Prime Minister Romano Prodi urged President Nazarbayev to avoid short-term solutions to long-term problems in the energy sector, focusing particularly on the Kashagan dispute and proposed amendments to Kazakhstan's law on subsoil use. Nazarbayev promised to carefully consider the subsoil amendments before acting and announced that Kazakhstan does not wish to rewrite the Kashagan Production Sharing Agreement (PSA). Nevertheless, Nazarbayev did not rule out the possibility that Kazakhstan will seek a substantial penalty from the consortium for delays at the Kashagan field. End Summary.

12. (SBU) Italian Prime Minister Romano Prodi traveled to Kazakhstan on October 8-9 for meetings with President Nazarbayev and other officials. Prodi's trip has been planned since April and was originally intended to center on strengthening trade ties between Italy and Kazakhstan. Although trade relations remained a focus of the visit, with over 200 Italian business representatives accompanying Prodi, Italy's Ambassador to Kazakhstan Bruno Asquino told Charge that energy issues also took center stage in the Nazarbayev - Prodi talks.

13. (SBU) Prodi's message on energy issues, said Ambassador Asquino, was straightforward - Kazakhstan should avoid short term solutions to long-term solutions. (Note: Ambassador Asquino told Charge that Italy believes that Kazakhstan faces economic difficulties because of the credit crunch and is overreacting.) Nazarbayev responded said that he will carefully consider the amendments to the law on subsoil use before approving them. (Note: Both the Mazhilis and the Senate have approved the amendments, which would allow Kazakhstan to break contracts to protect national interests.) Nevertheless, Nazarbayev justified the amendments by claiming that the U.S. has similar legislation.

14. (SBU) Ambassador Asquino told Charge that no breakthrough was reached on Kashagan. Nazarbayev did announce publicly that Kazakhstan will not seek to rewrite the Kashagan Production Sharing Agreement (PSA). He also added, however, that the AGIP consortium developing Kashagan could face a breach of contract suit. "If investors violate an agreed contract, Kazakhstan reserves the right to take measures according to our domestic legislation." For his part, Prodi told Nazarbayev that a renegotiation of terms within the PSA would be acceptable. Prodi also urged Kazakhstan to "leave it to the experts," and to "get it out of the headlines."

15. (SBU) Charge also asked Ambassador Asquino whether Prodi and Nazarbayev discussed Kazakhstan's bid to chair the OSCE in 2009. According to the Ambassador, Nazarbayev does not expect a consensus decision. Italy, however, decided some time ago to support the bid, said the Ambassador. He noted that 30% of Italy's daily gas consumption comes through

Russia. Germany is an even stronger supporter of Kazakhstan's bid, he added.

¶6. (SBU) Comment: Romano Prodi's visit was a valuable opportunity for a high-profile leader to deliver directly to President Nazarbayev a message of concern regarding recent developments in Kazakhstan's energy sector. Prodi's discussions with Nazarbayev indicate that Nazarbayev understands the sensitivity of the amendments to the subsoil use law and that he will not seek to abandon the Kashagan PSA. Nevertheless, with the GOK still likely to levy a substantial penalty on AGIP, Chevron facing a \$600 million environmental fine, the recent establishment by the Finance Ministry's Tax Committee of a special unit to focus specifically on western energy companies, and a domestic economic downturn spurring a populist reaction from some politicians, the coming months look to be bumpy ones for western energy companies in Kazakhstan. End Comment
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